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SUBMISSION

TO THE

ONTARIO COMMITTEE

ON

TAXATION

BY

THE CANADIAN BANKERS' ASSOCIATION

50 King Street West
Toronto 1, Ontario

TORONTO, ONTARIO JANUARY 17, 1964

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The Canadian Bankers' Association

50 KING STREET, WEST
TORONTO 1, ONTARIO

Area Code No. 416
Tel: 362-7521

January 17, 1964

The Ontario Committee on Taxation,
88 University Avenue,
Toronto 1, Ontario.

Gentlemen:

1. The chartered banks of Canada wish to convey to The Ontario Committee on Taxation their recognition of the valuable work being undertaken by the Committee and their appreciation for the opportunity of expressing the views of the banks on the important matters being studied.

2. The views of the banks on taxation have recently been submitted in a brief to The Royal Commission on Taxation and a copy of the brief is enclosed.

3. The banks would like to draw the attention of the Committee to the following portions of their brief to The Royal Commission on Taxation as it is felt that the views are applicable to provincial taxes as well as federal taxes.

Taxation Policies	-	Sections 23 to 31
Investment by Canadians in Canadian Equities	-	Sections 32 to 36
Credit Unions and Caisses Populaires	-	Sections 40 to 45
Estate Taxes	-	Sections 74 to 80

4. The banks would also like to express their ideas on the following aspects of Taxation in Ontario:

(a) Taxation of corporations with no permanent establishments in Ontario but maintaining bank deposits therein

Section 6(2) of The Corporations Tax Act provides that every corporation not having a permanent establishment in Ontario but which merely holds assets in Ontario shall for every

fiscal year of the corporation, in addition to all other taxes for which it may be liable, pay a tax of $50.

Because bank deposits are not excluded from the assets to which the above section refers, a Canadian or foreign corporation with no permanent establishment in Ontario will be liable for an annual Ontario tax of $50 if it maintains a bank account in the Province of Ontario. The tax and attendant returns are obvious deterrents to opening such accounts in the Province even when business reasons favour it. For this reason corporations with no permanent establishments in Ontario generally restrict their bank deposits to provinces other than Ontario so that the latter province receives neither the $50 tax nor whatever benefit may accrue from increased bank deposits within the Province. It is therefore suggested that the Act should be amended to exclude bank deposits from the assets to which Section 6(2) applies.

(b) The Ontario Succession Duty Act

Preamble

Ontario is one of three provinces in Canada which does not "rent out" the Succession Duty field to the Federal Government. This two-tier method of extracting death duties gives rise to real problems amongst bank customers. It is felt that it would be desirable if the Succession Duty could be replaced by an Estate Tax. However, it is suggested that, even if a Succession Duty is found necessary or desirable, it may be possible to simplify taxing procedures.

Administration

It would be most helpful if the administration of the Ontario Succession Duty Act could correspond as closely as

possible with that of the Federal Estate Tax Act. For example, section 11 of the Ontario Act forbids the opening of a deceased's safety deposit box without the prior written approval of the Treasurer. The banks have been authorized by the Treasurer to open boxes and list the contents without this prior written approval, except in the Toronto area. We advocate that the Federal procedure under regulation 6 (section 48) Estate Tax Act be followed by the Province in the interest of speed and simplicity, permitting a bank officer to represent the taxing authority in the listing of a depository's contents.

We also advocate that the documents which may be withdrawn from any depository should be the same as under the Federal Act (section 48(2)).

Non-Residents

The Federal Estate Tax Act imposes a special (15%) rate of estate duty on the Canadian property of deceased individuals who were not domiciled in Canada at the date of death. In Ontario, property passing in the province is subject to Ontario Succession Duties at the rate computed by reference to the deceased's world property regardless of its situs and regardless of the domicile of the deceased. From time to time, the banks have to explain to executors why the province has to have information about the world property of a deceased individual who was domiciled abroad but who had a deposit with a chartered bank in Ontario. Aside from the fact that there is inevitable delay in obtaining a clearance certificate from the Provincial taxation authorities in such circumstances, a very heavy duty in relation to the amount of Ontario property can accrue. Many foreign customers of the banks find it prudent to have their Canadian banking business transacted in provinces which do not impose a Succession Duty.

Yours very truly,

W. M. Currie,
President

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SUBMISSION

TO THE

ROYAL COMMISSION

ON

TAXATION

BY

The Canadian Bankers' Association

50 KING STREET WEST
TORONTO 1, ONTARIO

OTTAWA, ONTARIO JANUARY 20, 1964

The Canadian Bankers' Association

50 KING STREET WEST
TORONTO 1, ONTARIO

Area Code No. 416
Tel: 362-7521

Kenneth LeM. Carter, Esq., F.C.A.
Chairman, and Commissioners
The Royal Commission on Taxation
Ottawa, Canada

Gentlemen:

1. The chartered banks of Canada wish to commend the members of the Royal Commission for undertaking the onerous duties of this most important inquiry and to express the hope that their efforts will result in measures of lasting benefit to Canada as a whole.

2. The Canadian Bankers' Association is the Association of the eight Canadian banks chartered under the Bank Act:

Bank of Montreal
The Bank of Nova Scotia
The Toronto-Dominion Bank
La Banque Provinciale du Canada
Canadian Imperial Bank of Commerce
The Royal Bank of Canada
Banque Canadienne Nationale
The Mercantile Bank of Canada

3. The objects of the Association are to promote generally the interests and efficiency of banks and bank officers.

4. The chartered banks have close and continuing contact with virtually every business organization in Canada and with most Canadian citizens. The network of branches of the chartered banks, consisting of 5,400 branches in Canada and 175 offices in other countries, puts the chartered banks in very close touch with economic developments of importance to all Canadians. The progress and success of the chartered banks is linked directly with the progress and success of the Canadian economy as a whole. The Canadian banks are act-

ively engaged in the international banking business, and are, therefore, closely concerned with the competitive position of Canadian business in international trade.

5. The banks appreciate the opportunity of making this submission to the Royal Commission and hope that in presenting the brief which follows, the facts and opinions set out will be of assistance in your deliberations.

6. This submission is divided into the following sections:

A. Summary of Conclusions and Recommendations (Pages 3-8).

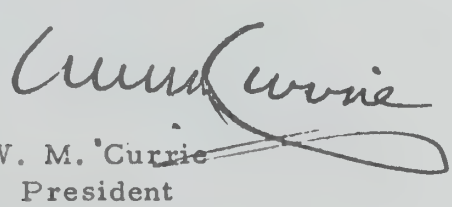
B. Government Revenues and Expenditures and Taxation Policies (Pages 9-17):
Comments on the general structure of these revenues and expenditures, on taxation policies, and on some of the main economic consequences of current developments in the government sector of the economy.

C. Income Taxes (Pages 18-28):
Detailed comments on and recommendations for improvements in certain provisions of the present income tax law.

D. Estate Taxes (Pages 29-32):
This section deals with the scope of these taxes as a source of Government revenue and the burden that these taxes can place on the estates of those in comparatively modest circumstances and refers to the effect of these taxes on Canadian ownership of Canadian industry.

E. Specific Questions Referred to The Canadian Bankers' Association by the Royal Commission's Staff (Pages 33-44):
This section deals with certain of these questions on which the Association felt that it could usefully comment and which are not covered in the earlier parts of the brief.

Yours very truly



W. M. Currie
President

SECTION A

SUMMARY OF CONCLUSIONS AND RECOMMENDATIONS

7. The largest part of the revenues of the federal government is derived from income taxes on personal incomes and on the incomes of corporations. There can be no question but that the heavy rate of corporation taxation together with a steeply graduated personal income tax must have a very substantial effect on costs of production in Canada, on our competitive position in world markets, and also on the incentives to work and produce, which are the basic driving force of a free enterprise economy. In order to achieve the maximum incentives for the expansion of business and individual enterprise, strong inducements through tax relief should be introduced.

8. The course of action which would be most effective as a first step to make possible a less stultifying tax structure would be a reduction in Government expenditures which, for all levels of Government, totalled almost $13 billion in 1962 and accounted for 32% of gross national product as compared with 26.5% in 1953. Some important reductions could be attained by increased efficiency in Government operations and by curtailing wherever possible some of the current Government programmes. It is recommended that serious study should be given to the question of whether any portion of welfare programmes, which already account for almost one-fifth of the total federal budgetary expenditures, might be placed on a self-sustaining

basis with the required contributions being made by those who would normally expect to be beneficiaries. The principle of contributions for benefits received should have a salutary effect on the whole nature and spirit of welfare programmes, would instil in each participant a sense of responsibility and would serve to bring into proper focus the full cost of such programmes and particularly of any proposed increases in the scales of payments.

9. One of the issues repeatedly raised in Canada is the matter of investment by Canadians in the equity stock of Canadian corporations which, in turn, is related to the high degree of foreign ownership of Canadian industry. It is suggested that in order to bring about a greater participation by Canadians the emphasis should be on positive measures encouraging such participation rather than on measures designed to discourage capital inflow or to penalize investment already made in Canada by non-resident investors. A modification of the steeply graduated income tax structure together with a general reduction in rates would be an important step to make possible increased investment by Canadians in Canadian equity securities. The Income Tax Act already provides an incentive to Canadians to invest in Canadian stocks in the form of the 20% dividend tax credit. Consideration should be given to providing a greater degree of incentive either by increasing substantially the rate of dividend tax credit or through arrangements along the lines of the suggestion already before the Commission (contained in the Report of the Special Committee on Corporate Taxation) under which Canadian dividend income of residents would be taxed at a flat 15% rather than at the

ordinary personal income tax rates.

10. Study is also required of the effect of estate taxes and succession duties on ownership of Canadian industry. It would appear that the level of such duties has been such as to force the sale of Canadian-owned enterprises to foreign interests and relief in this area should be given through a reduction in the rates of these duties. A further measure of relief should be introduced through providing arrangements under which such duties may be paid over a reasonably long period of time at a favourable rate of interest.

11. A valuable incentive to Canadian ownership of our industry could be provided at a relatively nominal cost through providing exemptions from estate taxes for domiciled decedents for portions of estates which consist of stocks of Canadian corporations up to a value of, say, $50,000.

12. The present favourable taxation provisions applicable to credit unions, including caisses populaires, result in losses to the federal, provincial and municipal treasuries and constitute an important competitive advantage to this form of organization of business enterprise. It is recommended that the present tax advantages conferred on credit unions should be closely reviewed, especially as they relate to those which have attained a large size and whose activities have become increasingly indistinguishable from other financial enterprises.

13. It is recommended that machinery be established within the Department of Finance or the Department of National Revenue through which consultations with foreign tax authorities may be conducted so that early rulings may be obtained with a view to eliminating double taxation.

14. Where part of a Canadian taxpayer's operations is carried on in a foreign jurisdiction, the allocation of taxable income as determined by the taxpayer when filing returns with the two jurisdictions may subsequently be changed as a result

of mutual agreement between the Canadian and foreign taxing authorities. Changes should be introduced into the present Canadian income tax law so that penalties are not imposed on the Canadian taxpayer because of such a reallocation.

15. Contributions by corporations to welfare and educational institutions are recognized by business as being part of the normal cost of business. However, because of the method by which foreign tax credits are computed under Section 41 of the Income Tax Act, a portion of such Canadian donations is effectively disallowed in the calculation of the net Canadian tax payable. It is recommended that this inequity be removed and that charitable donations by a corporation be allowed as an expense in the computation of income rather than as a deduction in the computation of taxable income.

16. Corporations carrying on part of their operations outside North America are not at present allowed to deduct for Canadian income tax purposes the charitable contributions which they make in the foreign countries where their business is conducted. A corporation should not be penalized by the Canadian tax authorities for accepting its social responsibilities in the foreign jurisdiction and it is recommended that, provided they are reasonable in amount, such donations be allowed as a deduction in the computation of world income taxable in Canada.

17. Section 41 of the Income Tax Act provides a credit for income tax paid to the Government of a foreign country subject to the limitation that the credit may not exceed the Canadian tax otherwise payable on income derived from sources in that country for the year. Due to differences in methods of determining income, profits may be taxable in Canada and a foreign country in different years. To eliminate double taxation in these cases it is recommended that:

(a) provision be made for the carry-over of the

excess of foreign taxes paid and

(b) that taxpayers be given the right to file an amended return and obtain a refund in respect of a foreign tax claim when the foreign tax is paid after the time for filing a notice of objection for the original amount has expired.

18. The provisions of Section 41 of the Income Tax Act provide a credit on account of income taxes paid to the central governments of foreign countries; no credit is allowed on account of similar taxes paid to political subdivisions of these countries. On account of the nature of these latter taxes (viz. because they are levied on income), it has been the practice also to deny them as a deductible expense for income tax purposes. These taxes are, however, a cost of doing business and should be allowed as a deduction from taxable income.

19. Section 11(1)(cb) of the Income Tax Act denies as a deductible expense commissions paid in the course of issuing or selling shares or borrowing money. Such commissions are as much a cost of the financing as printing, legal and accounting expenses. Also, the commissions are taxable in the hands of the recipients. It is recommended that such commissions should be allowed as a deduction for income tax purposes.

20. At the present time a capital cost allowance of 100% is permitted with respect to a limited class of property which includes certain utensils, instruments and tools costing less than $100. All property items in this cost range are especially subject to obsolescence and early replacement, no matter what the nominal length of their physical lives. For this reason as well as for the further practical one of reducing record-keeping and administrative costs, it is recommended that Schedule B of

the Capital Cost Allowance Regulations be amended so as to include in Class 12 any property that is a tangible capital asset costing less than $100 and which is not included in any other class.

21. As well as broadly reducing death duties as a step toward encouraging Canadian ownership of Canada's industry, it is recommended that exemptions be increased where a widow survives. This would give some recognition to the part that the wife plays in the accumulation of what is, fundamentally, a family estate and would provide a necessary measure of relief especially where there are children.

22. It is also suggested that death duties on widows' pensions and annuities be payable through withholding at source from each pension or annuity payment made instead of as a lump sum at the time of the husband's death.

SECTION B

GOVERNMENT REVENUES AND EXPENDITURES AND TAXATION POLICIES

23. This section touches on some of the broader economic implications of certain taxation policies and of the current levels of government revenues and expenditures. It has not, however, been feasible to make a detailed analytical study of the complex issues involved. Rather, it represents the consensus of opinion of the members of The Canadian Bankers' Association concerning some of the important consequences of the present situation, particularly as it affects the efficiency and competitive position of Canadian business enterprises. Most of the matters raised are of general application, or relate to difficulties or anomalies affecting others that bankers have observed in the normal course of their business; few if any of the comments raise questions that relate solely to banks. All these issues are matters of great concern to this Association as a responsible Canadian business organization, and it is our hope that the views expressed will be helpful to the Commission in pursuing its own thorough analysis of all the implications of any proposals for improvement in the tax laws.

Growth in Government Expenditures

24. An examination of the statistics on government expenditures in Canada shows at once the immense expansion over the years in such expenditures, both in absolute terms and as a proportion of the nation's Gross National Product. Total expenditures, for example, by all levels of government have risen from $6.6 billion in 1953 to $12.9 billion in 1962. Included as Appendix I to this submission is a statistical summary which sets out for quick reference expenditures and revenues, and the deficits and surpluses of all three levels of

government in Canada from 1953 to 1962.

25. As a percentage of Gross National Product, total government expenditures had already reached 26.5 per cent in 1953 and had risen to 32 per cent in 1962. The following table shows this development, in detail, for each level of government.

Total Government Expenditure* as Per Cent of G.N.P.

	1953	1954	1955	1956	1957	1958	1959	1960	1961	1962
Federal	16.7	16.9	15.9	14.9	15.1	16.5	15.7	15.6	16.0	15.5
Provincial	4.7	5.1	5.2	5.4	5.7	6.2	6.8	7.5	7.9	8.0
Municipal	5.1	5.5	5.7	5.8	6.3	6.9	7.3	7.8	8.3	8.5
Total	26.5	27.5	26.8	26.1	27.1	29.6	29.8	30.9	32.2	32.0

*Excluding inter-government transfers

26. It is also of interest to note how large a proportion of these total expenditures is made up of transfer payments and subsidies of various kinds. When these are eliminated the following percentages emerge as the proportions of G.N.P. accounted for by direct government expenditures on goods and services:

Government Expenditure on Goods and Services as Per Cent of G.N.P.

	1953	1954	1955	1956	1957	1958	1959	1960	1961	1962
Federal	10.2	9.8	9.3	8.8	8.5	8.7	8.1	7.5	7.9	7.4
(Defence)	(7.6)	(6.9)	(6.5)	(5.9)	(5.5)	(5.0)	(4.5)	(4.3)	(4.3)	(4.2)
Provincial	2.8	3.0	3.1	3.4	3.5	3.7	3.9	4.0	3.9	4.0
Municipal	4.7	5.1	5.3	5.4	5.8	6.4	6.6	7.1	7.4	7.7
Total	17.7	17.9	17.7	17.6	17.8	18.8	18.6	18.6	19.2	19.1

27. The above figures deal primarily with expenditures. The tables in Appendices II, III, and IV, contain a breakdown of the sources of revenue of each of the three levels of government, setting out in some detail direct and indirect taxes, withholding taxes, and other revenues.

Corporation and Personal Income Taxes

28. With respect to the revenue of the federal government, the largest part is derived from income taxes on personal incomes and on the incomes of corporations. There can be no question but that the heavy rate of corporation taxes (in effect, 21% on first $35,000 of taxable income and 50% on remainder) together with a steeply graduated personal income tax which rises rapidly to 50 per cent of taxable income and continues on up to 80 per cent, must have a very substantial effect on costs of production in Canada and on the incentives to work and produce.

Possibilities for Reducing Expenditures

29. The Commission will no doubt be faced with many possible schemes for altering the incidence of taxation or for trying to raise a similar volume of revenue in ways which may be politically more acceptable or economically less damaging. However, if there is any agreement as to the impact of taxation on incentives, the only solution must be some reduction in the proportion of additional income or additional profit extracted from individuals and corporations. In fact, it may well be the case that after some period of adjustment lower rates may yield a higher return by virtue of the increased economic activity which may be induced. Profits and personal income have a vital role to play in our economic system and if the economy is to grow and develop successfully there must be adequate rewards for risk-taking and initiative.

30. The course of action which would be most effective as a first step to make possible a less stultifying tax structure would be a reduction in government expenditure. While some important reductions can no doubt be attained by achieving economies wherever possible, substantial reductions will be feasible only if some of the major current public programmes are curtailed. At the present time the two great areas of

federal government expenditure are defence and welfare payments. Some 25 per cent of total federal expenditures are devoted to defence and veterans' pensions, and about the same percentage is allocated for health and welfare payments including family allowances and old age security payments. We do not, of course, have full control over defence expenditures, the amount of which must be appraised in the light of the international situation and our international obligations. Even so, we should scrutinize these vast expenditures with the greatest care to try to ensure that they do make the most effective contribution to our national security. Welfare payments, on the other hand, are fully within our domestic control. Transfer payments for welfare purposes are, as the name implies, transfers of income from those who have earned it to the beneficiaries of the welfare programmes. The heavy taxation necessary to produce these transfer payments, by its adverse effect on the economy as a whole may well mean that the living standards of the country as a whole are lower than they might otherwise be. In short, a substantial proportion of welfare payments may be made at the expense of productive investment which would otherwise be available to provide productive employment and earned incomes.

31. One suggestion which the Commission might consider is whether any portion of the welfare programme could be removed from the federal budget and placed on an insurance basis, to be financed by premiums paid by those who would normally expect to be beneficiaries. The principle of contributions for benefits received should have a salutary effect on the whole nature and spirit of welfare programmes. It would instil in each participant a sense of responsibility and would focus attention on the full cost involved. This approach might be particularly relevant for any proposed increases in these programmes,

although such increases should also be rigorously examined in terms of their cost and the competitive consequences for the economy.

Investment by Canadians in Canadian Equities

32. One of the issues which is repeatedly raised in Canada is the matter of investment by Canadians in the equity stock of Canadian corporations. This in turn is, of course, related to the high degree of foreign ownership of Canadian equity stocks. It would seem clear that the steeply rising rates of taxation of personal incomes must have some impact on this matter. The present taxation system which consists essentially in imposing taxes where they are easiest to collect, impedes the creation of capital in Canada. Some changes in the marginal rates of personal taxation could make a significant difference to the amounts of income available for investment. It has been suggested, for example, that a flat rate of 16 per cent on all taxable income would produce approximately the same revenue as the present structure graduated from 11 per cent to 80 per cent. Some such modification of the steeply graduated income tax structure would be the most important immediate step which could be taken to make possible increased investment by Canadians in Canadian equity securities.

33. The increased funds made available for investment by the above step could, of course, be greatly augmented if, in addition, there were a major reduction in government expenditures, making possible an across-the-board reduction in levels of taxation. It can be noted, in this connection, that the rates which would apply in the United States, under the tax proposals currently before the Congress, would range from a minimum of 14 per cent to a maximum of 70 per cent.

34. The Income Tax Act already provides an incentive to

Canadians to invest in Canadian stocks in the form of the 20% dividend tax credit. Consideration should be given to providing a greater degree of incentive either by increasing substantially the rate of dividend tax credit or through arrangements along the lines of the suggestion already before the Commission (contained in the Report of the Special Committee on Corporate Taxation) under which Canadian dividend income of residents would be taxed at a flat 15% rather than at the ordinary personal income tax rates. Another area which must be surveyed is the need to make it possible for Canadian owners to continue to hold family businesses where, at present, the pressure of death duties frequently leads to foreign take-overs.

35. To the extent that a net capital inflow continues to be necessary for balance of payments reasons, any steps taken to encourage Canadian ownership of Canadian equity stock must also avoid disrupting non-resident investment in Canada. Some efforts have been made to encourage foreign investors to switch from equities to bonds, but it is important to keep in mind that, whereas the casual investor in shares may be persuaded to switch to Canadian bonds, the non-resident concerned with controlling the operation of a Canadian business is not at all likely to be persuaded to switch his funds into bonds or other obligations.

36. Another related factor is that the present tax system tends, in general, to discourage equity financing in favour of either debt financing (where the interest cost is a deductible expense) or the use of internal funds. While it is certainly not suggested that anything should be done to discourage the latter two sources of financing, equity financing could be encouraged by a reduction of the impact of income taxes on individuals and corporations. This could well lead to a much greater interest in equity investments on the part of individual Canadian investors, and make a contribution towards reducing, gradually, the present

dependence on foreign capital.

Tax Considerations in Relation to the Form of Business Organization

37. The advantages or disadvantages, from a tax point of view, of various forms of business organization is one of the topics in which the Commission staff has indicated an interest.

38. One aspect of this question relates to the decision as between incorporation and proprietorship or partnership. The tax considerations involved are complex, and almost a matter of separate calculation in each case, and it is therefore difficult to distinguish any consistent or systematic impact on economic decisions of these tax provisions.

39. However, the special tax advantages for co-operative enterprises, including credit unions, as compared to the corporate form of enterprise, do raise important questions of economic policy and of equity.

Credit Unions and Caisses Populaires

40. Credit unions and caisses populaires (hereinafter referred to, collectively, as credit unions) like other enterprises organized in similar ways, are subject to special income tax provisions which in general are based on the principle that they are not subject to corporate tax as long as their net earnings are passed on to their members in approved forms. In addition, they obtain a further advantage through being generally exempt from municipal taxes.

41. This is a matter of general economic interest and of particular interest to the chartered banks since some credit unions are now of considerable size and compete vigorously over a wide area of financial activity. There has been a great deal of debate on this subject, but there

can be little serious argument over the basic point that credit unions are largely exempted from taxation, or taxed at very nominal rates. So far as the corporate form of business organization is concerned, the latest available taxation statistics show that in 1961 "total active taxable companies excluding co-operatives and Crown corporations" paid in Federal income taxes an average tax rate of 37.7 per cent. The actual corporation income tax, provincial and federal, on all income over $35,000 is, of course, at least 50 per cent, and somewhat higher in some provinces. The credit unions' tax advantage has not unnaturally led to a very rapid expansion in their membership and in the volume of their business.

42. The table in Appendix V reveals that, compared with chartered banks and provincial government savings offices, credit unions have grown at a much faster rate in the past 14 years. Further, this trend gives no indication of slackening.

43. One of the principal reasons underlying credit union growth has been the higher rate of interest that they are able to pay depositors. Contributing substantially to this has been their exemption from income taxation (Section 62(1)(k) Income Tax Act).

44. Some idea of the importance of this advantage can be obtained from the fact that the banks have paid an average of over $82 million per year in income taxes over the past five years. The amounts paid in taxes have represented between one per cent and 1 1/4 per cent of average personal savings deposits during this period.

45. Thus not only does the exemption of credit unions from income taxation result in losses to the federal, provincial and municipal treasuries, it also operates as an unfair

competitive advantage against the banks and other financial institutions. It is recommended that the present tax advantages conferred on credit unions should be closely reviewed especially as they relate to those which have attained a large size and whose activities have become increasingly indistinguishable from other financial enterprises.

46. As for provincial government savings offices, who also pay no income tax, the competitive factor vis-a-vis the banks would not appear to be of great importance. From time to time these institutions have paid rates of interest fractionally higher than the banks and the non-payment of income tax at such times probably has contributed to their ability to do so.

SECTION C

INCOME TAXES

Taxation of foreign business income

47. Canada shares with many other western countries the basic philosophy that income arising in one tax jurisdiction and remitted to another should not be taxed by both jurisdictions. It has, too, accepted the principle that taxation by source should have precedence over taxation by residence. As a result there has been incorporated into the Income Tax Act and Regulations, provisions designed to relieve the Canadian taxpayer of at least some of the double taxation which would otherwise be levied on income in his hands. If Canadian business with foreign operations is to compete successfully outside Canada it is important that the relieving provisions be liberally interpreted so that the intent of the legislation is not nullified. Greater Canadian participation in foreign business fields is an important objective of government and industry and it is vital that deterrents be eliminated wherever possible.

48. Section 41 of the Act, bolstered by reciprocal tax agreements with most of Canada's principal trading partners, largely eliminates (as far as lies in Canada's power) the double taxation of foreign income received by Canadian taxpayers. That it is not completely effective is due less to any basic shortcoming in Section 41 itself than in other provisions of reciprocal conventions and the income tax law or in their application.

Need for machinery for consultation

49. For instance, Article XVI of the Canada-U.S. Reciprocal Tax Convention states:

> "Where a taxpayer shows proof that the action of

> the revenue authorities of the contracting State has resulted in double taxation in his case in respect of any of the taxes to which the present Convention relates, he shall be entitled to lodge a claim with the State of which he is a citizen or resident or, if the taxpayer is a corporation or other entity, with the State in which it was created or organized. If the claim should be deemed worthy of consideration, the competent authority of such State may consult with the competent authority of the other State to determine whether the double taxation in question may be avoided in accordance with the terms of this Convention."

50. The taxpayer's position is an especially difficult one if he must await assessment by both taxing authorities before he can be assured that in given circumstances "double taxation may be avoided in accordance with the terms of the Convention". He should, instead, be able to refer to the competent tax authorities of Canada and the foreign country, jointly, matters relating to his foreign operations, including, where this is feasible, plans which he has in mind with regard to his foreign business, and get from them a ruling on the tax aspects. He could then give proper weight to the tax problems when making his business decisions. It is suggested, therefore, that there should be established in the Department of Finance, and/or the Department of National Revenue, machinery (say an international tax section) to which such matters might be referred by the Canadian taxpayer, not only when double taxation has resulted but when double taxation may be in prospect. This international section would bring the taxpayer's inquiry into consultation with its opposite number in the foreign country so that a joint decision might be reached. It seems probable that the two consulting authorities would more readily be able to reach a reasonable compromise if the consultation occurred before either (or both) had made decisions or given rulings that resulted in double taxation. This is therefore an especially important time at which to obtain a ruling.

Elimination of interest penalties where taxable income is reallocated.

51. Of course, not all instances of double taxation can be foreseen and it is to be expected that claims will still be lodged by taxpayers where double taxation has occurred. In these cases, even if double taxation is overcome, the taxpayer will, under present procedures, almost certainly suffer additional tax costs or penalties in the form of interest on reassessments.

52. For example, Section 54(1) of the Act subjects an underpayment of Government of Canada income tax to an interest charge of 6%. Because this interest is held not to be "interest on borrowed money used for the purpose of earning income from a business or property" it is not allowed as a deduction from taxable income under Section 11(1)(c).

53. Section 57(3) of the Act provides that an overpayment of Government of Canada income tax will bear interest at 3%. Since interest is brought into taxable income by virtue of Section 6(1)(b), interest received on overpayments of tax is subjected to income tax.

54. For a corporation paying top 50% income tax rates these provisions mean, in after-tax funds, 6% interest charged on underpayments and only 1-1/2% interest allowed on overpayments.

55. The taxing authorities justify this fourfold penalty by saying that Government should not make it possible for a taxpayer to borrow cheaply by underpaying taxes or to receive a high yield from monies deposited with the Government through overpaying taxes. There may be validity in this argument for the purely domestic taxpayer, that is, for the Canadian taxpayer who has not business income from foreign sources, but for the Canadian taxpayer with foreign operations it is highly inequitable.

The purely domestic taxpayer will avoid interest penalties if his tax payments are based on the lesser of (a) the current year's income, or (b) the immediately preceding year's income. The taxpayer with foreign operations, however, can be subjected to interest penalties even though he has remitted total domestic and foreign tax payments based on income greater than that finally assessed to him.

56. The inequity arises when, on assessment, total taxable income is reallocated between different tax jurisdictions. For instance, the taxpayer in his return may have allocated total taxable income of $3,000,000 as $2,000,000 taxable in Canada and $1,000,000 taxable in country "A" which also taxes at 50%. Total tax is therefore $1,500,000 - $1,000,000 to Canada and $500,000 to country "A". On assessment (which in the U.S., for instance, may be up to three years later) the assessors of both countries agree that in the light of developments (perhaps recent case history) the allocation of taxable income should be $1,500,000 in Canada and $1,500,000 in country "A". Total tax, of course, is still $1,500,000 but is assessed as $750,000 to Canada and $750,000 to country "A". The Government of Canada pays interest on the overpayment of tax which it has received; country "A" charges on the underpayment owed to it but allows the charge as a deduction from taxable income. The effect to the Canadian taxpayer, however, is far from an offset. For example, if assessment or reassessment came three years after filing, the taxpayer in the present example would effectively be taxed a further $33,750:

6% on $250,000 for 3 years paid to country "A" but not allowed as a deduction by Canada	$45,000
Less 3% on $250,000 for 3 years received from Canada, less tax	11,250
	$33,750

This penalty would be suffered notwithstanding that he had originally paid all the taxes for which he is now assessed and had paid them at the stipulated time. Because his taxable income is simply reallocated as between tax jurisdictions, he is penalized without justification. In fact, in the circumstances cited, the Government of Canada receives a net amount of $11,250 from the adjustment (and country "A", $22,500):

Reduction in foreign tax credit by Canada re country "A" - 50% of $45,000 interest	$22,500
Less interest paid by Canada of $22,500, minus tax thereon	11,250
Net gain by Government of Canada	$11,250

Accordingly, Canada in effect receives the use of the overpayment of $250,000 interest-free for three years and in addition a premium of $11,250.

57. The above treatment can give rise to the following anomalous situation: a Canadian taxpayer with a branch in the U.S. files a U.S. tax return on which he is taxable at $X and in his Canadian return claims the full foreign tax credit in that amount. Two years after filing his U.S. return and before it has been assessed he finds that he can make a claim which will reduce his income taxable in the U.S. although not affecting his world income taxable in Canada. If he makes such claim now he will get a refund from the U.S., plus interest which will be taxable in Canada, and will pay the tax over to Canada together with an interest penalty which he will not be permitted to deduct from taxable income. Thus if he makes the claim against the U.S. he will improve the Canadian Revenue's position but only at the expense of having to bear the cost of the interest penalty even though he has in no way benefited from the move.

58. If interest on underpayments and overpayments of tax in Canada were, like the U.S., calculated at 6% and accountable in the tax return as both income and expense, this anomaly would not arise. If it is felt that there are good reasons which make such general provisions undesirable, then the penalty should at least be eliminated when it arises from mutually agreed reallocation of taxable income among jurisdictions.

Charitable Contributions

59. Contributions by business corporations to welfare and educational institutions are nowadays recognized by corporations as part of the normal cost of business and are accepted as such in management plans. That this view is shared in Government is apparent from statements made from time to time in budget presentations. In his 1958 budget speech, the Minister of Finance said that a high level of private participation in the contributions to welfare and education was most desirable and he hoped that the amendment which he was then introducing, by way of raising to 10% of income the limit of contributions deductible, would swell the flow of funds from industry to the support of such causes.

60. In practice, however, the Canadian taxpayer who has income which is taxed abroad as well as in Canada will find that not all of his seemingly eligible contributions to Canadian welfare and educational institutions are deductible in determining his net Canadian tax payable.

61. In computing corporation tax in Canada at the present time, charitable donations are deducted from income to arrive at taxable income (Section 27(1)(a)). It is by reference to income and not taxable income, however, that a foreign tax deduction may be computed under Section 41. This means that nominally allowable donations to Canadian welfare

and education can be effectively disallowed in the calculation of the net Canadian tax payable.

62. Take the example of a corporation with a taxable income of $2,000,000 of which one-half is earned in the U.S.A.:

U.S. tax on taxable income of $1,000,000 is (say)	52% of $1,000,000			$ 520,000
Canadian tax on taxable income of $2,000,000 is	21% of $	35,000	$ 7,350	
plus	50% of	$1,965,000	982,500	
		$2,000,000	$989,850	

Effective rate is $\frac{\text{tax}}{\text{income}} = \frac{989,850}{2,000,000} = 49.4925\%$

Foreign tax credit is 49.4925% of $1,000,000	494,925	494,925
Aggregate tax		$1,014,925

63. If the same corporation donates $200,000 to Canadian charity, its Canadian tax bill will not be reduced by 50% of $200,000 as was surely intended by the legislators:

U.S. tax on taxable income of $1,000,000 is as before				$ 520,000
Canadian tax on taxable income of $1,800,000 is	21% of $	35,000	$ 7,350	
plus	50% of	$1,765,000	882,500	
		$1,800,000	889,850	

Effective rate is $\frac{\text{tax}}{\text{income (not taxable income)}} = \frac{889,850}{2,000,000}$

$= 44.4925\%$

Foreign tax credit is 44.4925% of $1,000,000	444,925	444,925
Aggregate tax		$ 964,925

64. By contributing $200,000 to Canadian charity the corporation reduces its tax bill by $50,000, equivalent to only 25% of the donation - not the 50% to be expected or by which the tax bill would have been reduced if the outlay had been, say, for advertising rather than welfare contributions. This is an anomaly which should not be allowed to persist and it is recommended that for income tax purposes charitable donations by a corporation should be treated as an expense in the computation of income rather than as a deduction in the computation of taxable income.

65. The philosophy which recognizes contributions to Canadian welfare and education as ordinary, acceptable deductions from a corporation's income, should as readily accept as deductions similar contributions made by the corporation in the course of its business in foreign countries. While the Canada-U.S. Reciprocal Tax Convention provides that donations made to U.S. charitable organizations by a Canadian taxpayer doing business in the United States will have the same status of deductibility as those made to Canadian charitable organizations, there are not similar provisions with regard to such expenditures in other countries. Such expenses should not be disallowed, per se, as "charitable donations" but should be granted as deductions except to the extent that they offend Section 12(2) as not being an expense "reasonable in the circumstances". The Canadian corporation in business outside North America should not be penalized by the Canadian tax authorities for accepting its recognized social responsibilities in the foreign jurisdiction.

Provision needed for carry-over of foreign tax credits

66. Because methods of computing taxable income differ from one tax jurisdiction to another, a Canadian business with foreign operations may frequently find that its profits from those operations are taxable in Canada and the foreign country in different years. In those circumstances the present provisions of Section 41 of the Income Tax Act will not prevent double taxation even though that is the intent of the Section.

67. For instance, in computing taxable income in Canada a business loss will be carried back one year but in the United States it will be carried back three years; in Canada when a depreciable capital asset is disposed of for less than its original cost, capital cost allowances are adjusted either by recapture or by further grants on the basis of the asset's diminishing balance

but in some other countries a balancing charge or a balancing allowance is made in the year of disposal; in Canada a taxpayer's income may be computed on an accrual basis but in a foreign country part of it at least may be taxed on a cash basis. In all these instances the Canadian and foreign tax authorities bring the same profits and expenses into calculation of taxable income but in different years. Since Section 41 grants tax credits to the Canadian taxpayer only with respect to foreign tax paid on income of the year, the difference in timing in income calculation can result in double taxation.

68. The circumstances cited above are a deterrent facing the Canadian taxpayer who is considering establishing business abroad and in equity, as well as with the aim of removing disincentives to expansion in international fields, the anomaly should be corrected. It is recommended that Section 41 provide that the unused portion of a foreign tax credit may be carried over to the same taxation years as business losses, i.e., the immediately preceding year and the five next succeeding years.

69. Because a taxpayer's income for a given year may be assessed at different times in Canada and in foreign countries, he may be assessed additional foreign tax for a taxation year in respect of which he is barred by the lapse of time from filing with the Canadian tax authorities a Notice of Objection or an application for a refund notwithstanding that the additional foreign tax would increase his foreign tax credit under Section 41. It is recommended that the taxpayer be given the right to file an amended return and obtain a refund in respect of a foreign tax claim when the foreign tax is paid after the time for filing a Notice of Objection for the original amount has expired.

All taxes paid local authorities should be deductible

70. The provisions of Section 41 of the Income Tax Act provide a credit on account of income taxes paid to the central governments of foreign countries; no credit is allowed on account of similar taxes paid to political subdivisions of these countries. On account of the nature of these latter taxes (viz., because they are levied on income), it has been the practice also to deny them as a deductible expense for income tax purposes. These taxes are, however, a cost of doing business and should be allowed as a deduction from taxable income.

Commission paid on raising capital

71. Section 11(1)(cb) of the Income Tax Act provides that there may be deducted in computing taxable income all expenses incurred in the year in the course of issuing or selling capital stock or borrowing money to earn income except the amount paid as a commission or bonus for the underwriter or salesman.

72. Such a commission is as much a cost of the financing as the other expenses such as printing, legal and accounting expenses. Also, as with legal and accounting fees, the commission is taxable in the hands of the recipient. It is recommended that such commissions be allowable as a deduction for income tax purposes.

Capital cost allowances - minor expenditures

73. At the present time a capital cost allowance of 100% is permitted with respect to a limited class of property which includes certain utensils, instruments and tools costing less than $100. All property items in this cost range are especially subject to obsolescence and early replacement, no matter what the nominal length of their physical lives. For this reason as well for the further practical one of reducing

record-keeping and administrative costs, it is recommended that Schedule B of the Capital Cost Allowance Regulations be amended so as to include in Class 12 any property that is a tangible capital asset costing less than $100 and which is not included in any other class.

SECTION D

ESTATE TAXES

74. The impact and scope of the Estate Tax Act can be appreciated by examination of the relative figures for 1961 which appeared in "1962 TAXATION STATISTICS" and have been reproduced as Appendix VI. In 1961 the reported figures show particulars of 3,452 taxable estates domiciled in Canada, and 1,933 foreign domiciled estates which produced a revenue of $57.4 million to the Canadian Government. Also in 1961 the governments of Ontario and Quebec collected Provincial Succession Duties of $37.6 million and $22.8 million respectively. (Reference: Tables 48 and 46, Provincial Finances 1963 by Canadian Tax Foundation).

Need for Increased Exemptions

75. While there are basic exemptions eliminating taxation on the majority of estates, the Estates Tax Act, and the Provincial Succession Duties Acts where applicable, can still impose a real burden where a relatively modest estate is left and a widow and children survive. It seems unjust that so little cognizance is taken of the part that the wife plays in making possible the accumulation of what is, in fact, a family estate. In many cases, especially where there are children, the husband's death will mean a severe curtailment of the family's standard of living and it is contended that their mutual savings should not at the time of the husband's death be taxed to the point of adding to the widow's already difficult circumstances. Payment of estate tax may well mean that the widow must promptly dispose of some of the estate assets at less than they are worth to her.

76. By way of some relief it is recommended that the exemption provided in the Estate Tax Act for Canadian domiciled decedents be increased to a basic exemption of $50,000 for all estates that the additional exemption of $20,000 for

the estate of a deceased male person survived by a spouse be increased to $50,000 and that all other exemptions provided in existing legislation be continued. This would give some recognition to the contribution which the wife had made toward building the estate as well as acknowledging the continuing fall in the purchasing power of the Canadian dollar.

Basis of payments of estate tax on pensions and annuities

77. Pensions, annuities, etc., are included in an estate for taxation purposes at their capitalized value. The present legislation makes some small recognition of the problems of liquidity and uncertainty as to the exact value of the pension benefits, (a) by permitting estate tax to be paid in six annual instalments if the property passing is an income right or annuity and there are not other realizable assets from which the tax can be paid, and (b) by providing for re-assessment in the event of the death or remarriage of the beneficiary within four years. However, these provisions by no means fully cover the situation which could be corrected without serious loss of tax revenue.

78. It is suggested that death duties attributable to a survivor's pension should be levied only on the pension actually received and be payable only as pension payments are made. The annual, monthly or other periodic tax payment might be computed in the same fashion as is set out in Section 11(1)(v) of the Income Tax Act, that is, by first determining the cash value of the pension at date of the deceased's death by reference to valuation tables and then dividing the estate tax attributable thereto by the number of payment periods in the expected life of the recipient as indicated by the tables. The resulting periodic estate tax pay-

ments (monthly, quarterly or annual to conform with pension payments) would be withheld by the payer of the pension as long as pension payments were made. When pension payments ceased, liability for estate tax on the pension would also cease. It is to be expected that tax revenues would not seriously be reduced through this procedure since in the instances when pension was paid beyond computed life expectancy the tax would be greater than now levied. These cases would offset to greater or lesser degree the instances when computed life expectancy was not reached. It is appreciated that the proposed procedure would require some additional amount of clerical work in administration but this ought not to be a deterrent to adopting a procedure which gives just recognition to the effect on her inheritance of a widow's early death or remarriage. An important point, too, is that the course suggested would reduce estate tax payments in the early years of widowhood when the widow's needs are greatest. It is also the case, of course, that the net pension payment after deduction of death duties would be the amount subject to income tax in the recipient's hands after taking into account the allowance granted by Section 11(1)(v) of the Income Tax Act. The death duty payments would, in fact, be the allowances deductible under that provision.

Incentive for Canadian ownership of Canadian industry

79. The level of estate taxes and succession duties has been such as to force the sale of Canadian-owned enterprises, often to foreign interests, and in order to provide relief in this area consideration should be given both to reducing the rates of these duties and to providing arrangements under which such duties may be paid over a reasonably long period of time at a favourable rate of interest.

80. A valuable incentive to Canadian ownership of our industry could be provided at a very nominal cost through providing exemptions from estate tax for domiciled decedents for portions of estates which consist of stocks of Canadian corporations up to a value of, say, $50,000. The figure of $50,000 is, of course, only a suggestion but a concession of this nature in estate tax legislation could provide an important incentive in encouraging Canadians to purchase stocks of Canadian industries rather than bonds.

SECTION E

SPECIFIC QUESTIONS REFERRED TO THE CANADIAN BANKERS' ASSOCIATION BY THE ROYAL COMMISSION'S STAFF

81. Specific questions were referred to The Canadian Bankers' Association by the staff of the Royal Commission. This section deals with certain of these questions on which the Association felt that it could usefully comment and which are not covered in the earlier parts of this brief.

Investment Decisions

82. "What influence has existing tax legislation had on the investment decisions of the chartered banks? What particular forms has it taken and to what extent has it been reflected in the composition of chartered bank assets?"

83. Canadian tax legislation has had little effect on the investment decisions of the chartered banks. Unlike individuals and many other corporations, banks include in their taxable income the profits and losses on disposals of bonds. For this reason they are not directly concerned with tax implications in choosing between discount and premium bonds. Since there are no tax free bonds in Canada the choice between Government of Canada, provincial, municipal or corporation bonds is not influenced by this type of consideration.

84. In the foreign field Canadian banks find it preferable in the main to carry on business through branches rather than in the form of subsidiary corporations. Since branch profits or losses are included in the world income for Canadian tax purposes, the foreign income is taxed at the full Canadian rates with credits being allowed for foreign income taxes up to the amount of the Canadian rate. Under these conditions tax free bonds issued by foreign jurisdictions are not attractive to Canadian banks because the income would be taxed at the full Canadian rates, whereas their tax free feature tends to create an artificially low yield. However, notwithstanding their lack of attractiveness from a net yield standpoint, as financial instit-

utions operating within these countries the Canadian banks are deeply conscious of their moral responsibility to purchase government and municipal bonds. Indeed the banks are expected to participate in such purchases regardless of yield and risk considerations. For example, both in the Dominican Republic and Puerto Rico the tax laws provide that income from certain government bond issues is free of tax. But as the Canadian tax rate is higher than that in these countries the effect of the exemption is only to decrease the banks' tax liability in these areas and reduce by an equivalent amount the tax credit obtainable in Canada under Section 41. In Puerto Rico the tax exemption is offset by a low rate of interest and this makes such an investment still less attractive to Canadian banks. American banks, however, are exempt from U.S. tax in respect of the Puerto Rican government bond income, which makes such an investment both commercially and politically beneficial. Canadian banks, therefore, are operating at a disadvantage in that they have a heavier levy on their profits as compared with competitor banks either resident in the country or from any other country which gives a tax preference to this type of income. This obviously tends to weaken the competitive position and general standing of Canadian banks.

85. "Has the tax free dividend been an important consideration affecting chartered bank decisions to make equity investments in Canadian corporations?"

86. One of the primary functions of a chartered bank is to make loans. Since loans vary as a result of seasonal, cyclical and irregular influences, a chartered bank must be able to adjust its other earning assets up and down fairly readily in order to accommodate its borrowing customers and the investment portfolio permits this to be done.

87. A large proportion of a bank's deposits (about 40 per

cent) is in current accounts which are legally payable on demand, and most of the balance is in personal savings deposits which in practice are also paid on demand, even though notice could be required. In order to have cash to meet any withdrawal, large or small, on demand and without the slightest qualification as to its immediate availability, a bank must have readily realizable investment assets in addition to cash itself.

88. The structure of a bank's investment portfolio must accordingly be such as to permit adjustments in it with a minimum of loss when investments are disposed of to meet borrowers' requirements and the demands of depositors. The emphasis must be on liquidity and security. These essential criteria call for an investment portfolio predominantly comprising bonds of high quality and with maturity dates spread over a relatively short period of years. While equities may be of high investment quality and may be readily marketable in the sense of being saleable at a price, no equity investment can provide advance assurance of availability of a known amount of funds at a known future date.

89. Because of the reasons outlined above, banks do not purchase equity investments in Canadian corporations to any large extent. The fact that the dividend is received free of tax is an inducement to such investment but because of the great consequences of the other considerations stated, equity investment must be of modest proportions.

Allocation of income

90. "Do major anomalies arise in allocating income to particular provinces and countries? How could Regulation 404 and Section 41 be improved in this respect?"

91. Section 40 of the Act permits a Canadian tax-paying corporation to deduct from its federal income tax otherwise payable a stated percentage of that part of its income which is deemed to have arisen in a Canadian province and which may therefore be taxed by the province. Very reasonably, the Act does not ask the tax-paying corporation to keep all its books of account on a territorial basis but instead allocates its taxable income among the provinces in accordance with a prescribed formula. In the case of the chartered banks the allocation is made in accordance with Regulation 404 which provides for an arbitrary formula based on the geographical distribution of (a) loans and deposits, and (b) wages paid to employees. While the result can only be an approximation of the actual amount of taxable income earned in a province, it is difficult to suggest any more satisfactory basis of computation. As long as the federal and provincial tax authorities follow the same formula for allocating income (as is generally the case to-day) and as long as the rates of tax levied by the provinces do not differ materially one from another, the tax-paying corporation is little affected by the method of allocation under Section 40. In any event the extra costs of keeping territorial books of account would outweigh such additional tax cost as is likely to result from misallocation by formula.

(The question of allocation of income to particular countries together with Section 41 of the Income Tax Act have been dealt with earlier in this submission in Section C).

Income Tax Provisions - Reserves

92. "Are the provisions relating to reserves against losses on loans, bad and doubtful debts, depreciation on assets other than bank premises and against other such contingencies adequate from a tax point of view? What alternative methods should be considered? In what respect are the present provisions more generous than those accorded other financial institutions?"

93. Under Section 11 (4) of the Income Tax Act a chartered bank, in computing its income for a taxation year may deduct "such amount as is set aside or reserved for the year either by way of write-down of the value of assets or appropriation to any contingency reserve or contingent account for the purpose of meeting losses on loans, bad or doubtful debts, depreciation in the value of assets other than bank premises, or other contingencies, and is, in the opinion of the Minister of Finance, having regard to all the circumstances, not in excess of the reasonable requirements of the bank".

94. The Bank Act requires that the loans of a bank be stated "less provision for estimated loss" and that all securities other than Canadian Federal and Provincial be stated at "not exceeding market value". To fulfill these requirements the banks deduct the above-mentioned reserves, known as inner reserves, from the total value of loans and eligible investments and show only a net or realizable value for these assets.

95. The entire concept of inner reserves was reviewed in considerable detail during the proceedings leading up to both the 1944 and 1954 revisions of the Bank Act. In 1944 the importance of inner reserves as a factor in maintaining the confidence of depositors, while at the same time giving management the freedom of carrying on the lending function effectively was explained by the Minister of Finance when he said in part:

> "It will be apparent from what I have said that the inner reserves of the banks are nothing more or less

than the reserves for bad and doubtful debts which the banking business requires. They constitute the first line of defence against losses on loans and losses on investments which may have to be realized in cash on a large scale and on short notice and which by law cannot be valued at more than current market prices. If the public functions of banking are to be performed, if the banks' demand obligations to their millions of depositors are to be met, and if the banks are to provide credit freely for the needs of trade and industry, these reserves must be adequate to absorb the shocks of adverse business conditions or fluctuations in security markets. If inner reserves are inadequate, bank managements will be hesitant to grant credit freely and take the risks that proper service to the public requires. If as a result of inadequate inner reserves, banks have frequently to resort to published rest funds to meet inevitable losses on loans or shrinkage in the value of their investments, public confidence will be impaired - may be lost altogether. Once confidence is impaired, the need for inner reserves becomes all the greater. As a last resort, the central bank may come to the rescue but reliance on the central bank should not be a steady diet or be any excuse for failure of the chartered banks to maintain themselves in a sound and strong condition."

96. In 1944 the Bank Act was amended to charge the Minister of Finance with specific responsibility for determining the amount which, in his opinion, was a reasonable appropriation for a bank to make each year to its inner reserves and since that time the Minister of Finance has issued periodically the Rules by which he makes this determination. From 1944 to 1954 the Rules issued by the Minister first defined the assets in respect of which contingency reserves were permitted and then specified a percentage to be applied to each class of assets to arrive at the allowable reserve. The reserves so calculated were originally in addition to the specific reserves that a bank was permitted to take in order to reduce the book value of the relative assets to estimated realizable value. In 1955 the Rules were changed so that only the greater of the specific or contingency reserves on each class of assets was allowed. Again in 1957 permitted reserves were further modified to disallow reserves of any kind on certain classes of assets including Canadian Federal and Canadian Provincial securities, and finally in 1960 the fixed percentage

levels for the different classes of assets were replaced by a single, variable percentage for the total of specific and contingency reserves, the percentage being based on a moving average loss experience for the past 25 years for the banking system as a whole.

97. Reserves are a cushion against the contingencies of the future rather than those of the past and any allowance based solely on historical experience may often be inappropriate to current circumstances. It follows that if a certain percentage for inner reserves is considered adequate for a given year the actual loss experience for that year is not necessarily an accurate guide for the determination of this allowable percentage in future years. Even though losses themselves are not discernible when loans are granted, accepted accounting practice dictates that provision should be made for unidentifiable but potential losses at that time, and the banks are faced with the need for making appropriations to their inner reserves in time of prosperity with the full knowledge that these reserves will be drawn against in periods of high loss experience.

98. The application of the existing formula means that each year in the present cycle the banks are replacing low average assets and relatively high loss experience by high average assets and low loss experience. Consequently the current formula for determining the total of specific and contingency reserves produces a somewhat anomalous result. A number of consecutively good years will push the allowable percentage down at the very time that reserves should be built up. This is evidenced by the sharp reductions which have occurred in the allowable percentages for the years 1960, 1961 and 1962 as listed in the February 4, 1963 issue of Hansard (p. 3388). Business has been at a relatively high level with comparatively low losses and no major downturns for more than

twenty years - certainly the longest sustained period of high activity in modern history. Indeed the twenty-five year average used in calculating the allowance for 1963 contains only two years of the thirties and two of the best at that, 1938 and 1939.

99. Because of the substantial reduction which has taken place in the reserve percentage allowable and because of the other changes made in recent years in the Rules issued by the Minister of Finance, the total allowable reserves for 1962 showed no change from the total permitted level for 1952, notwithstanding the fact that the aggregate assets of the banks over this 10-year period doubled from $10.2 billion to $20.3 billion. If the downward trend in the allowable percentage continues, the point may be reached where the low level of reserves begins to affect the banks' day-to-day operating decisions in the extension of credit. Inadequacy of contingency reserves can hardly help but influence the viewpoint of the banks in formulating their credit policy. With reserves at a minimum following a period of prosperity they might well be compelled not only to hesitate in a subsequent recession to make the very type of loans that would be helpful in stimulating recovery but also to be less lenient in carrying a borrower through his own difficult periods.

100. It is the opinion of the banks that the present formula is inadequate and its continued application will result in an allowable percentage so low as to defeat the purpose of inner reserves, and it may be that the present permitted level is already down to a point below which it may be undesirable to go. For this reason, the adoption of the principle of establishing a "floor" below which the formula would be inoperative is recommended. While the decision of where this "floor" should be established is a matter

of judgment and not susceptible of accurate determination, it is the considered view of the banks that it should be above the permitted level for the 1962 year so that they may be in a position to take normal credit risks in all kinds of financial weather.

101. Regarding the question as to whether or not the present provisions relating to the reserves permitted chartered banks are more generous than those accorded other financial institutions, it is not considered that a valid comparison can be made because of the special nature of the role played by the chartered banks in the nation's economy. There is a particular need for banks to retain adequate reserves in order to maintain stability and public confidence during periods of difficult business conditions.

102. A similar view was expressed by the Cohen Committee on Company Law Amendment in the United Kingdom:

> "In the case of banking companies, the interests of the depositors outweigh the interests of the shareholders and considerations affecting the public interest must be taken into account. The reputation for stability of these companies is a national asset of the first importance to the community in general, and it is not in the public interest to endanger their stability or the confidence they enjoy at home and abroad. History demonstrates the public advantage of their being able to present a reasonably stable position in a time of violent and sudden stress and for this reason, it seems to us desirable that such companies should be permitted to retain a buffer of undisclosed reserves."

Deductions of Taxes at Source

103. "What difficulties might arise in deducting a fixed percentage of investment income at source? Are similar problems encountered in administering the provisions relating to withholding taxes or would the difficulties be different in kind?"

104. At present the banks, in common with other corporations, withhold tax on dividends paid to their non-resident shareholders. Of the total shareholders of the chartered banks

at the end of 1962, 14 1/2% were non-residents:

		%
Resident in Canada	93,309	85 1/2%
Non-resident	15,901	14 1/2
	109,210	100%

105. To extend this type of tax to include resident shareholders would increase the volume of work and accordingly add to the costs involved in the disbursement of dividends, although the additional costs would not likely be unreasonably high.

106. The banks have already experienced such a tax on dividends payable to residents during the period September 1, 1942 to December 31, 1945 when Canada imposed a 7% withholding tax on selected forms of investment income such as dividends. At that time the tax did not apply to interest coupons nor to interest on bank savings accounts. We would suggest that the Commission have its research staff ascertain from the Department of National Revenue the costs and problems which were involved in administering this tax.

107. Substantial difficulties would arise, however, if the banks were required to withhold tax on interest paid on savings accounts and when negotiating interest coupons as a vast number of individual deductions would be required. Some idea of how great the volume would be can be gauged from the fact that as at the end of 1962 the Canadian Chartered Banks had approximately 11 1/2 million personal savings accounts. In addition, they had thousands of other interest-bearing accounts. Trust Companies and other near banks would also have millions of similar accounts.

108. In the case of interest coupons, a very great number are handled each year by the banks as they are deposited or cashed by customers. The banks are already faced with a heavy volume of work in having to make out ownership certificates on

account of interest coupons negotiated and this would be substantially added to if it were necessary also to calculate and deduct tax from each individual item deposited or cashed.

109. The withholding of a tax from interest on savings accounts and from interest coupons negotiated would, without question, result in a great deal of extra work and costs to the banks. In addition to making the necessary tax calculations and accounting for and periodically remitting the amount of the deductions, there would be substantial administrative costs in reporting the individual yearly income totals and relative deductions to the Department of National Revenue and the payee; all of the foregoing would result in a great mass of extra paper work being generated, not only for the banks but for the Government. In this connection it is pointed out that the administrative problems would also be added to inasmuch as deductions would have been made in a great many instances from the income of payees who are not taxable and this would result in a large increase in the number of tax returns filed for the sole purpose of claiming refunds. It would not be feasible to attempt to overcome the foregoing difficulties by means of an exemption for individuals whose total income did not exceed a stated amount because of the great number from whom declaration forms would be required.

110. The above difficulties could be lessened if there were limits of, say, $50 or $100 set on the individual amounts of income from which tax was required to be deducted at source but in this regard it must be recognized that as far as interest coupons are concerned, the vast majority which are encashed by customers are in relatively small amounts.

111. If the procedure of deducting tax from the source were adopted the administrative costs involved would have to

be taken into account and a reasonable rate of compensation on this account allowed.

112. Similar problems are not encountered to anywhere nearly the same extent in administering the withholding of taxes deducted from remuneration to employees or from payments to non-residents.

113. In the first instance the workload is spread over a great number of individual employers. Also as an employee files a declaration of his exemptions, there are relatively few cases of overdeduction of tax and this accordingly overcomes the problem of tax refunds.

114. In the case of deductions from payments to non-residents, there is no problem from a tax refund standpoint as such deductions are not refundable by the Government of Canada, the non-resident having to look to his own taxation jurisdiction for any relief.

Rights to Subscribe to Capital Stock

115. "To what extent is the distribution to shareholders of rights to subscribe for additional capital stock at price below prevailing market values (in accordance with S36 of the Bank Act) governed by knowledge that such rights do not constitute taxable income in the hands of recipients? What, if any, are the economic consequences of this form of distribution relative to the payment of dividends?"

116. The fact that rights to subscribe for additional capital stock received by shareholders do not constitute taxable income in their hands is not a factor that the banks take into consideration in deciding to raise additional share capital. A guiding principle followed by a bank's management in reaching such a decision is the maintaining of what the management considers is a proper relationship between the shareholders' equity and the total of the bank's deposit liabilities.

C. GOVERNMENT EXPENDITURES AND REVENUES

	1953	1954	1955	1956	1957	1958	1959	1960	1961	1962
Expenditures					(Millions of dollars)					(Prelim.)
Goods and Services										
Federal	2,559	2,449	2,510	2,683	2,728	2,854	2,832	2,725	2,974	3,008
(Defence)	(1,907)	(1,727)	(1,760)	(1,802)	(1,765)	(1,661)	(1,559)	(1,546)	(1;613)	(1,680)
Provincial	695	747	846	1,041	1,128	1,222	1,349	1,456	1,455	1,606
Municipal	1,178	1,265	1,436	1,662	1,866	2,104	2,309	2,574	2,776	3,107
Total	4,432	4,461	4,792	5,386	5,722	6,180	6,490	6,755	7,205	7,721
Transfer Payments to Persons										
Federal	1,046	1,161	1,232	1,224	1,463	1,899	1,791	1,979	2,015	2,122
Provincial	377	429	463	500	564	677	895	1,073	1,299	1,421
Municipal	38	44	42	42	49	61	69	77	94	109
Total	1,461	1,634	1,737	1,766	2,076	2,637	2,755	3,129	3,408	3,652
Interest on Public Debt										
Federal	461	504	494	524	519	544	678	756	783	855
Provincial	91	97	97	105	114	119	126	153	163	177
Municipal	58	68	78	85	106	119	159	187	218	242
Total	610	669	669	714	739	782	963	1,096	1,164	1,274
Subsidies										
Federal	106	84	75	118	108	131	189	210	221	260
Provincial	4	2	7	5	8	15	16	26	33	31
Total	110	86	82	123	116	146	205	236	254	291
Total Expenditure (Excluding inter-government transfers)*										
Federal	4,172	4,198	4,311	4,549	4,818	5,428	5,490	5,670	5,993	6,245
Provincial	1,167	1,275	1,413	1,651	1,814	2,033	2,386	2,708	2,950	3,235
Municipal	1,274	1,377	1,556	1,789	2,021	2,284	2,537	2,838	3,088	3,458
Total	6,613	6,850	7,280	7,989	8,653	9,745	10,413	11,216	12,031	12,938
Revenues										
Total Revenue (Excluding inter-government transfers)*										
Federal	4,726	4,528	4,937	5,578	5,588	5,334	6,043	6,426	6,668	6,907
Provincial	1,188	1,246	1,409	1,598	1,877	1,987	2,240	2,353	2,605	3,285
Municipal	874	945	1,040	1,163	1,288	1,417	1,574	1,726	1,853	1,976
Total	6,788	6,719	7,386	8,339	8,753	8,738	9,857	10,505	11;126	12,168
Deficit or Surplus										
Deficit (−) or Surplus (+) (Adjusted for inter-government transfers)*										
Federal	+142	*−100*	+176	+544	+249	*−757*	*−327*	*−238*	*−453*	*−474*
Provincial	+203	+155	+134	+79	+144	+66	+112	*−92*	*−91*	+111
Municipal	*−170*	*−186*	*−204*	*−273*	*−293*	*−316*	*−341*	*−381*	*−361*	*−407*
Total	+175	*−131*	+106	+350	+100	*−1,007*	*−556*	*−711*	*−905*	*−770*

*Total expenditures and revenues for each level of government exclude those arising from inter-government transfers. In calculating the deficit or surplus for each level of government, however, the effect of such transfers has been taken into account.

Transfer payments from the Federal Government to Provincial and Municipal Governments have been as follows:

1953	$412 m.	1958	$ 663 m.
1954	$430 m.	1959	$ 880 m.
1955	$450 m.	1960	$ 994 m.
1956	$485 m.	1961	$1,128 m.
1957	$521 m.	1962	$1,136 m.

Source: Dominion Bureau of Statistics. *National Accounts Income and Expenditure*, annual and quarterly, Cat. Nos. 13-201 and 13-001.

FEDERAL GOVERNMENT REVENUES

APPENDIX II

CALENDAR YEARS - NATIONAL ACCOUNTS BASIS

(millions of dollars)

	1953	1954	1955	1956	1957	1958	1959	1960	1961	1962
Taxation:										
Direct - Persons	1,329	1,319	1,325	1,550	1,723	1,581	1,770	2,017	2,132	2,088
- Corporations	1,144	1,018	1,210	1,334	1,132	1,075	1,310	1,284	1,311	1,328
Total	2,473	2,337	2,535	2,884	2,855	2,656	3,080	3,301	3,443	3,416
Withholding	54	58	67	69	83	48	74	79	116	125
Indirect	1,697	1,612	1,744	1,972	1,990	1,912	2,125	2,180	2,190	2,400
Total	4,224	4,007	4,346	4,925	4,928	4,616	5,279	5,560	5,749	5,941
Other Revenue:										
Investment Income	232	234	267	296	276	327	350	384	409	448
Contributions to Social Insurance	270	287	324	357	384	391	414	482	510	518
Total	502	521	591	653	660	718	764	866	919	966
Total Revenue	4,726	4,528	4,937	5,578	5,588	5,334	6,043	6,426	6,668	6,907

PROVINCIAL GOVERNMENT REVENUES

APPENDIX III

CALENDAR YEARS - NATIONAL ACCOUNTS BASIS
(millions of dollars)

PROVINCIAL[1]	1953	1954	1955	1956	1957	1958	1959	1960	1961	1962
Taxation:										
Direct - Persons	97	112	159	165	176	195	297	320	354	600
- Corporations	76	64	62	79	205	240	271	278	301	422
Total	173	176	221	244	381	435	568	598	655	1,022
Indirect	613	655	739	846	937	960	1,043	1,091	1,244	1,516
	786	831	960	1,090	1,318	1,395	1,611	1,689	1,899	2,538
Other Revenue:										
Investment Income	271	289	309	346	367	390	413	425	455	478
Contributions to Soc. insce.	131	126	140	162	192	202	216	239	251	269
Transfers from										
- Canada	409	428	443	476	505	640	856	962	1,095	1,094
- Municipalities	15	15	22	18	28	17	24	16	14	17
	826	858	914	1,002	1,092	1,249	1,509	1,642	1,815	1,858
Total Revenue	1,612	1,689	1,874	2,092	2,410	2,644	3,120	3,331	3,714	4,396

(1) Includes Municipal Government Revenue for 1959 - 1962 period.

MUNICIPAL GOVERNMENT REVENUES

APPENDIX IV

CALENDAR YEARS - NATIONAL ACCOUNTS BASIS
(Millions of dollars)

	1953	1954	1955	1956	1957	1958	1959	1960	1961	1962
(2) Municipal										
Taxation:										
Direct - Persons	6	6	15	17	18	19	21	23	25	26
Indirect	711	766	836	941	1,050	1,156	1,296	1,435	1,536	1,636
Total	717	772	851	958	1,068	1,175	1,317	1,458	1,561	1,662
Other Revenue:										
Investment Income	148	164	177	192	206	220	235	244	266	285
Contributions to Social Insurance	9	9	12	13	14	22	22	24	26	29
Transfers from -										
- Canada	3	2	7	9	16	23	24	32	33	42
- Provinces	242	259	327	362	452	545	622	715	855	1,050
	402	434	523	576	688	810	903	1,015	1,180	1,406
Total Revenue	1,119	1,206	1,374	1,534	1,756	1,985	2,220	2,473	2,741	3,068

(2) Included with Provincial Government Revenue for 1959 - 1962 period.

Growth of Personal Savings in the Banks, Provincial Government Savings Institutions and Credit Unions

At Dec. 31*	Prov. Govt. Sav. Institutions Interest-Bearing Deposits			Credit Unions Shares and Deposits			Chartered Banks Personal Savings Deposits			
	Amount ($ Millions)	Index	Annual Increase (%)	1 Amount ($ Millions)	Index	Annual Increase (%)	3 Amount ($ Millions)	Index	Annual Increase (%)	3 ÷ 1
1949	101	100.0		264	100.0		4,086	100.0		15.5
1950	105	104.0	4.0	289	109.5	9.5	4,176	102.2	2.2	14.6
1951	105	104.0	-	334	126.5	15.6	4,296	105.1	2.9	12.9
1952	102	101.0	- 2.9	396	150.0	18.6	4,600	112.6	7.1	11.6
1953	107	105.9	4.9	453	171.6	14.4	4,756	116.4	3.4	10.5
1954	106	105.0	- .9	511	193.6	12.8	5,218	127.7	9.7	10.2
1955	122	120.8	15.1	603	228.4	18.0	5,633	137.9	8.0	9.3
1956	130	128.7	6.6	700	265.2	16.1	6,007	147.0	6.6	8.6
1957	130	128.7	-	787	298.1	12.4	6,108	149.5	1.7	7.8
1958	134	132.7	3.1	935	354.2	18.8	6,844	167.5	12.0	7.3
1959	139	137.6	3.7	1,060	401.5	13.4	6,900	168.9	.8	6.5
1960	132	130.7	- 5.0	1,208	457.6	14.0	7,215	176.6	4.6	6.0
1961	135	133.7	2.3	1,387	525.4	14.8	7,618	186.4	5.6	5.5
1962	141	139.6	4.4	n.a.	n.a.	n.a.	7,932	194.1	4.1	n.a.

* March 31 for Provincial Government Savings Institutions
Source: Bank of Canada Statistical Summary

TABLE 1 – ESTATE TAX – TABLEAU 1 – IMPÔT SUR LES SUCCESSIONS

FISCAL YEAR 1960-61 – *ANNÉE FINANCIÈRE 1960-1961*

TAXABLE ESTATES ASSESSED BY PROVINCE – *SUCCESSIONS IMPOSABLES COTISÉES PAR PROVINCE*

(All money figures in thousands of dollars – *En milliers de dollars)*

Province of Assessment / *Province de cotisation*	Number of Estates – *Nombre de successions*	Aggregate Net Value – *Valeur globale nette*	Less Exempt Property – *Moins biens exemptés*	Less Basic & Survivor Exemptions – *Moins exemptions de base et de survivants*	Aggregate Taxable Value – *Valeur imposable globale*	Tax on Taxable Value – *Impôt sur la valeur imposable*	Less Total Credits – *Moins total des dégrèvements*	Less Re-Assessments – *Moins nouvelles cotisations*	Net Estate Tax – *Montant net d'impôt sur les successions*
		$	$	$	$	$	$	$	$
Newfoundland / *Terre-Neuve*	27	3,178	20	1,510	1,648	307	13	–	294
P. E. I. / *Î. P.-É.*	7	786	2	450	333	59	2	1	56
Nova Scotia / *N.-É.*	120	16,309	273	5,985	10,051	2,148	99	32	2,017
New Brunswick / *N.-B.*	56	9,467	966	2,810	5,691	1,301	68	5	1,228
Quebec / *Québec*	619	114,112	4,152	32,385	77,575	20,201	10,008	114	10,079
Ontario / *Ontario*	1,679	251,935	4,600	84,945	162,390	41,817	20,915	341	20,561
Manitoba / *Manitoba*	158	19,299	108	8,455	10,736	2,291	135	1	2,155
Saskachewan / *Sask.*	144	16,495	136	7,530	8,829	1,927	32	13	1,882
Alberta / *Alberta*	234	30,092	305	12,440	17,348	3,636	159	26	3,451
B. C. & Y. T. / *C.-B. et T.Y.*	408	59,984	1,342	20,670	37,972	9,289	204	36	9,049
Estates: / *Successions:*									
Domiciled / *Domiciliées*	3,452	521,657	11,904	177,180	332,573	82,976	31,635	569	50,772
Foreign / *Etrangères*	1,933	49,143	–	–	49,143	7,374	261	459	6,654
Grand Total / *Total global*	5,385	570,800	11,904	177,180	381,716	90,350	31,896	1,028	57,426

TABLE 2 – ESTATE TAX – TABLEAU 2 – IMPÔT SUR LES SUCCESSIONS

FISCAL YEAR 1960-61 – *ANNÉE FINANCIÈRE 1960-1961*

TAXABLE CANADIAN DOMICILED ESTATES – *SUCCESSIONS IMPOSABLES DOMICILIÉES AU CANADA*

BY SIZE OF ESTATE – *SELON L'IMPORTANCE DE LA SUCCESSION*

(All money figures in thousands of dollars – *En milliers de dollars)*

Size of Estate – *Importance de la succession*	Number of Estates – *Nombre de successions*	Aggregate Net Value* – *Valeur nette globale**	Tax On Taxable Value – *Impôt sur la valeur imposable*	Total Assets – *Actif total*	Real Estate & Mortgages – *Biens-fonds et hypothèques*	Stocks & Shares – *Actions*	Bonds & Debentures – *Obligations*	Life Insurance Annuities, Pensions – *Assurance-vie, rentes, pensions*	Other Assets – *Autre actif*
		$	$	$	$	$	$	$	$
$ 50,000 – 74,999	1,142	71,932	2,389	75,499	24,669	13,505	12,682	7,941	16,702
75,000 – 99,999	781	67,437	4,051	70,574	22,938	12,783	9,739	8,830	16,284
100,000 – 124,999	403	44,836	3,884	47,188	13,869	11,011	6,398	5,807	10,103
125,000 – 149,999	301	41,172	4,376	43,214	12,253	10,752	6,560	5,010	8,639
150,000 – 199,999	287	49,360	6,490	51,381	12,674	15,505	6,610	5,509	11,083
200,000 – 299,999	256	62,172	10,366	64,330	15,273	21,201	9,105	5,716	13,035
300,000 – 399,999	116	39,937	7,718	41,620	8,194	17.592	4,867	3,370	7.597
400,000 – 499,999	53	23,836	5,233	24,267	3,686	9,986	4,856	1,347	4,392
500,000 – 599,999	27	14,787	3,606	15,272	2,340	6,783	3,005	985	2,159
600,000 – 699,999	23	14,837	3,779	15,645	2,024	6,410	2,963	802	3,446
700,000 – 799,999	11	8,222	2,070	8,312	450	4,560	1,317	477	1,508
800,000 – 899,999	4	3,319	949	3,386	456	1,539	324	367	700
900,000 – 999,999	11	10,473	2,876	10,682	505	5,001	2,391	315	2,470
1,000,000 – & over - *et plus*	37	69,337	25,189	70,630	3,666	27,731	9,872	2,167	27,194
Total	3,452	521,657	82,976	542,000	122,997	164,359	80,689	48,643	125,312

* The aggregate net value, is the equivalent of total assets less allowances of $20,343,000 for General Debts and Quick Successions.

* *La valeur globale nette correspond au total de l'actif diminué de $20,343,000 aux titres des dettes générales et des successions coup sur coup.*